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ENDING AMERICA'S 20-YEAR ADDICTION TO STEEL IMPORT RESTRICTIONS

INTRODUCTION

This September, the so-called Voluntary Restraint Agreements (VRAs) that limit imports of steel into the United States will expire. These restrictions, established in September 1984 by Ronald Reagan, were supposed to be temporary, ostensibly simply giving the American steel industry time to adjust to foreign competition. Five years apparently do not satisfy U.S. steelmakers. This industry now claims that it needs another five years of trade protectionism.

This is the question confronting George Bush. It is possible that he could decide this month whether to extend the VRAs or let them expire as they are supposed to. During the 1988 presidential campaign, Bush tentatively promised to support continuation of these restrictions unless foreign governments ended subsidies to their steel producers. This, however, would penalize the U.S. economy. Trade protection for U.S. steel harms American industries that use steel to make their products, it destroys jobs, and it exposes America's claim to support free trade as hypocritical. The Bush Administration thus should let the Voluntary Restraint Agreements expire.

37,200 Lost Jobs. Since 1968, the American steel industry has received various forms of U.S. government protection from imports. During these periods of protection, the industry failed to modernize; instead it yielded to union pressure and used the extra cushion provided by the import protection to give its workers huge wage increases. Periods of protectionism routinely have been followed by calls from the weakened American steel industry for more protection. Advocates of protection of the U.S. steel industries claim that it has saved as many as 17,000 jobs. Yet, job losses in industries that use steel are estimated at 54,200 as a result of import restrictions. Thus the VRAs since 1984 have cost the economy an estimated 37,200 jobs. It also is estimated that the VRAs cost the U.S. economy around $3.5 billion per year.

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Thus each job "saved" costs $200,000. Restrictions on imported steel, moreover, have harmed steel-using American industries by raising costs and restricting supply, thus making their products less competitive worldwide.

During the past few years, the American steel industry has recovered, however. This has been primarily because of the lower valued dollar, which raised the price of imports, and the cutbacks in employment and salaries in the industry itself. The large American steel manufacturers currently are making profits. The steel industry as a whole made an estimated $2 billion in profits last year, following a decade of losses. As for the many small American steel producers, the minimills, they are highly efficient and therefore profitable.

Unfair Advantage. The claim that restrictions on steel are necessary to counter steel subsidies by foreign governments is highly questionable. Foreign countries can correctly point out that the U.S. for two decades has used trade restrictions on steel in the same way that these countries have used subsidies. Subsidies are direct government payments to specific enterprises, whereas import restrictions allow certain businesses to charge higher prices without fear of competition. Both practices give certain businesses an unfair advantage over enterprises that do not have access to special government favors. Engaging in just the sort of market-distorting activities that it accuses others of, for example, renewing the VRAs, will make it even more difficult for the U.S. to promote open markets worldwide.

Trade protection of the American steel industry is a favor to a special interest group. Protection has made the industry itself less efficient, harmed other U.S. manufacturers, and cost the American economy billions of dollars in higher prices and tens of thousands in lost jobs. The Bush Administration should place the interests of the American economy first and break America's twenty-year addiction to restrictions on steel imports. The steel quotas should be scrapped.

ORIGIN OF THE QUOTAS

In 1984, the American steel industry petitioned the U.S. International Trade Commission (ITC) for protection from foreign steel imports under Section 201 of the 1974 Trade Act. The American industry claimed to be harmed by a surge of imports and sought relief to adjust to what it insisted was new competition. By a 3 to 2 vote on July 11, 1984, the ITC recommended that Reagan set quota limits on imported steel for five years to protect the U.S. steel industry. Then ITC Chairwoman Paula Stern and Vice Chairwoman Susan Liebeler voted against their fellow commissioners. They maintained that the industry's problems could be laid mainly to its own mismanagement. They explained that the greatest surge of imports had been in the early 1980s and that the U.S. industry already had adjusted to it. What American steelmakers faced in 1984, said Stern and Liebeler, was simply regular import competition. They warned that restrictions on steel imports

would cost steel-using U.S. business, as well as American consumers, billions of dollars.

Reagan rejected the ITC quota proposal. But that September, he instructed the U.S. Trade Representative to negotiate so-called voluntary restraint agreements (VRAs) with those countries exporting large quantities of steel to the U.S. Under the VRAs each government promised for five years to "persuade" their steel manufacturers to limit steel sales in the U.S. to predetermined amounts. The VRAs are scheduled to expire in September of this year.

THE HISTORY OF STEEL RESTRAINTS

The U.S. steel industry argues that VRAs should be renewed. According to the industry, current American production methods using coke ovens and blast furnaces are outdated and must be changed to meet competition from such countries as Japan and South Korea. Substitution of a one-step process involving the mixing of iron ore and coal with molten steel, instead of the three-step process that prevails in many American factories, is a key to modernization of the U.S. industry. Presumably, after these improvements are made, the VRAs can be cancelled. Yet the history of the U.S. steel industry over the past two decades teaches that protectionism slows, not spurs, industrial improvements and in the end results in calls for more protectionism by a weakened U.S. industry.

Breathing Space. The American steel industry's modern dependence on protection began in 1968. Then, an inefficiently run U.S. steel industry, facing a surge of imports, called for protection against foreign producers – mainly those in Japan and Europe. The industry was granted three years of VRAs by the Nixon Administration to buy breathing space for retooling and modernization. At the end of this period, the industry pleaded that it still needed time to modernize. In 1971 the VRAs were extended for another three years.

Once considered a sign of America's industrial strength, steel was the primary component of its most important, high value products, such as automobiles, bridges, and skyscrapers. After World War II, the U.S. was the world's largest steel producer. Strength in the U.S. steel industry was equated with American national strength. For these reasons, the U.S. government, with some degree of public support, was inclined to protect the American steel industry against what was perceived as "unfair" competition.

Wall of Protection. While the VRAs were in force from 1969 to 1974, capital expenditures for modernization by the U.S. industry fell while industries in competing countries continued to modernize. Furthermore, labor costs for the American industry continued to rise during this period even though productivity remained stagnant. Average wages rose from $9.90 per hour in 1970 to $17.46 per hour in 1980. This was 60 percent above the

average increase for the rest of U.S. manufacturing. Behind the wall of trade protection, management in the U.S. steel industry found it easier to buy labor peace by giving in to union demands for ever-higher wages than to hold the line on wages and invest in new, more efficient equipment and productive processes.

Anti-Dumping Trigger. During the 1970s, steel production abroad grew, yet worldwide demand for steel dropped. As low demand held down steel prices, the increasingly inefficient American industry found it difficult to compete. The U.S. industry then sought to stop imports by filing an increased number of anti-dumping suits against foreign firms, claiming that imported steel was being sold in the U.S. at too low a price. To make this tactic easier, the U.S. industry sought and received from Jimmy Carter in 1977 a Trigger Price Mechanism (TPM). Aimed primarily at Japanese firms, the TPMs set price floors for imported steel. If steel entered the U.S. at prices below these floors, an anti-dumping case was automatically triggered.

These devices curbed steel imports from Japan; the void was filled, however, by steel from Western Europe. In 1982 when the TPM expired, the U.S. government placed limits on steel imported from Europe. This did not placate the American steel industry. And in 1984, the industry convinced the Reagan Administration to return to the failed policies of the VRAs.[1]

The American steel industry thus, in various ways, has been protected for two decades. Instead of helping the industry, it has shielded it from the incentives it needs to streamline and modernize. The result: a chronically ailing steel industry perpetually calling for more protection.

WHAT STEEL QUOTAS COST AMERICA

Restrictions on steel imports have had a direct, costly, and adverse impact on the U.S. economy. A 1987 report by the St. Louis-based Center for the Study of American Business at Washington University estimates that, while the current quota restrictions may have saved 17,000 American steel industry jobs, they destroyed 54,200 jobs in U.S. industries that use steel. For every one job "saved" in the steel industry, three jobs were lost elsewhere.[2]

The Office of Management and Budget estimated in 1985 that four more years of VRAs would add around $18 billion to the costs of steel products for the five years of the quotas. This is over $3.5 billion annually. Therefore the VRAs have "saved" 17,000 jobs, with salaries averaging $40,000 annually, at a yearly cost of $200,000 a year per job.

1 Kent Jones, "Saving the Steel Industry," Heritage Foundation *Backgrounder* No. 354, May 21, 1984.

2 Arthur T. Denzan, "How Import Restraints Reduce Employment," Center for the Study of American Business, June 1987, p. 5.

HARMING AMERICAN COMPETITIVENESS

By raising the prices of steel and in some cases limiting supply, the VRAs have undercut the ability of many American manufacturers of products with steel components to compete with foreign manufacturers both in the U.S. and overseas. The Coalition of American Steel Using Manufacturers charges that, while American enterprises have been forced to buy expensive American steel, their Japanese competitors can use lower cost products. This is confirmed by the Stern Report, which found that from 1969 to 1985 American manufacturers paid 20 percent to 25 percent more for steel than their foreign competitors. This imposed an annual burden of more than $5 billion on the U.S. economy. Thanks to the current VRAs, American manufacturers using steel were subject to price increases from steel suppliers averaging 15 percent during 1987 and 1988, even though the cost of steel production has fallen.

Lost Sales. The current restrictions on steel imports, for example, have seriously harmed Caterpillar Inc., a major American machinery manufacturer. In the past, yellow Caterpillar construction vehicles were found not only in the U.S. market but in most overseas markets as well. Recently Caterpillar's foreign sales have dwindled because of the high cost of steel. Says Timothy Elder, Caterpillar's Manager of Governmental Affairs, "We oppose steel quotas because steel accounts for as much as 15 to 20 percent of our production costs. We and our workers are paying the price for protecting the U.S. steel industry through higher prices and shortages of steel." During the early 1980s, Caterpillar lost sales to Japanese, South Korean, and West European manufacturers, who have access to cheaper steel.

Import restrictions also have created steel shortages. Example: Lone Star Steel of Texas has been unable to meet the demand of the U.S. market for its flat rolled steel coil. The reason: U.S. restrictions on imports have meant that Lone Star could acquire less than half the special raw steel it needs to fill the demand. The result: Lone Star is losing contracts to supply this valuable product to other American businesses, and overseas firms thus are able to dominate the U.S. market in this product area.

THE U.S. STEEL INDUSTRY TODAY

The problems plaguing the large American steel producers have been primarily of their own making. Failure to invest in more efficient production methods and granting wage boosts well above productivity gains have made the U.S. industry uncompetitive. The high value of the dollar in the early 1980s, which made steel imports cheaper, added to the industry's woes.

The recession in the early 1980s finally forced the large U.S. steel producers to make necessary changes. The VRAs had little to do with this. Bloated industry payrolls were cut by over 250,000 workers; total employment in the nation's steel mills is now 170,000, down from 435,000 in the pre-recession 1970s and the record 650,200 in 1953. Wages actually fell in

some areas of the industry. Inefficient operations were shut down.*[3] With the fall in the value of the dollar after 1985, imports became more expensive, easing some of the pressure on the large American producers.

Efficient Producers. Today U.S. steel producers are among the most efficient in the world in terms of the manpower necessary to produce a ton of steel. The U.S. currently uses an average of 6.5 hours of labor to make one metric ton of steel, compared to 9 hours in South Korea and 7.1 hours in Japan. The two giant American steel producers, USX Corporation (formerly U.S. Steel Corporation) and Bethlehem Steel Corporation, have added modern furnaces to some of their plants. The result has been an output of one ton of steel per 3.8 worker hours.

The American industry sometimes argues that, because it uses the least number of man hours to produce steel and still faces stiff competition from foreign firms, the foreigners must be engaging in unfair trade practices, such as charging prices that are too low. Yet American labor costs are extremely high by world standards. Thus the total production costs, including labor, result in prices for American steel that are higher than other countries' prices.

Even so, as a result of industry reforms, the large U.S. steel producers have made a comeback. While the American industry lost nearly $4 billion between 1983 and 1986, by 1987 it was again operating in the black. Last year, USX Corporation, America's largest steel producer, reported operating profits of $501 million, up 300 percent from the $125 million profit in 1987. The industry as a whole had an estimated $2 billion in total profits for 1988.

SMALLER AMERICAN COMPETITORS

Many smaller U.S. steel producers today are outperforming the rest of the industry, both foreign and domestic. The use of Employee Stock Ownership Plans (ESOPs) by some steel manufacturers has given employees incentives to work more efficiently and to keep salary demands in line with business productivity. Tardiness and sick days become less frequent, and overall productivity goes up. Under an ESOP, employees own shares in the business. When the business prospers, they make profits. The workers get bonus checks at the end of the year based on the performance of the plant. They are an integral part of the management, and major business decisions are made with worker input if not by the workers themselves.

In 1984, the West Virginia company, Weirton Steel Corporation was purchased by its employees to avoid bankruptcy. From 1984 through 1988, while much of the American steel industry was losing money, Weirton

3 "Steel Industry Is Up After Years of Decline," *The New York Times*, February 27, 1989, p. D1.

realized more profit for each ton of steel it produced than the average profit per ton of the top six U.S. steelmakers. The average annual bonus check is around $9,000 per worker.[4] Oregon Steel Mills, Inc., in Portland also adopted an ESOP; it was then able to cut its per worker hour average for one ton of steel from nine hours to three.

Versatile Minimills. Another American steel success story is the emergence of minimills. These are smaller independent steel manufacturers that have many advantages over the larger producers. There are now 40 minimills in the U.S., and their performance has been remarkable. Birmingham Steel Corp., for example, a minimill, has had a three-year average annual return on equity of 18.3 percent. During the same three-year period, LTV Corporation, a large integrated producer, lost an average of 11.6 percent annually on equity. Sales for Birmingham grew by 55.8 percent, while LTV sales dropped by 1.2 percent. U.S. minimills are taking part of the American market share back from foreign competitors. This is especially evident in the area of small structural products, such as wire rod.

The minimills have been successful primarily because their production costs are as low as any of the foreign producers of steel and lower than the large domestic firms. The minimills have modernized faster than the big integrated steel firms. Furthermore, the minimills have lower labor costs. Salaries for minimill workers are around $17.50 per hour compared with $22.80 per hour at larger U.S. steel firms.

Most U.S. minimills use electric furnaces in which inexpensive scrap iron is melted with iron ore. This simplified production method cuts time and cost. Minimills, moreover, can change production techniques quickly to meet very specific consumer demands. The finished product is not always a huge steel slab, such as those produced by the large integrated firms, but smaller finished products in many shapes. Minimills can produce steel to meet the constantly changing specifications for the shapes, sizes, and quality of steel. The larger integrated firm cannot meet such changes in demand as efficiently.

PROTECTIONISM AND SUBSIDIES

The large U.S. steel producers argue that they face unfair price competition from those foreign producers who are subsidized by their governments. They argue that restrictions on foreign steel imports should remain until subsidies are removed. Yet in so doing, American steel producers and the U.S. government too are guilty of unfair trade practices. It even could be argued, with some justice, that the twenty years of U.S. government protection of American steel producers prompted other

4 "Has Weirton ESOP Worked Too Well," *Business Week*, January 23, 1989, p. 66.

countries to subsidize their producers. The motive of American protectionists has been no different than that of protectionists in other countries: to win special favors for domestic industries.

U.S. Fiction. Advocates of continuing VRAs argue that limits should be retained on steel imports, in the name of free trade, to force foreign markets to open. But the very nature of the current U.S. trade restrictions on steel undermines efforts to open world markets. Under the General Agreement on Tariffs and Trade (GATT), the major international agreement governing trade, quota restrictions on most imports are illegal. The U.S. government has imposed just such quota restrictions on steel imports, using the fiction that they are "voluntary" restraints exercised by foreign countries or, more accurately, imposed on foreign businesses by their governments. Yet it is understood by the governments involved that the U.S. government will take some form of action against them if they fail to comply "voluntarily."

The steel industry, moreover, has received federal subsidies. In 1978, the Carter Administration bowed to the United Steel Worker's Union and granted $265 million in loan guarantees to four steel companies: Korf Industries, Inc., Wisconsin Steel Corporation, Wheeling-Pittsburgh Steel Corporation, and LTV Steel Corporation. The loans were to save 50,000 jobs. By 1987, all four loans were in default. So far, the American taxpayer has spent $176 million and not one job was saved. In fact, two of the four companies no longer exist, and the other two have applied for bankruptcy.

Countries that subsidize their steel production inevitably damage their economies, just as U.S. steel import restrictions harm American industries. A country providing subsidies from government funds must burden its own taxpayers to pay for them.

CONCLUSION

The U.S. government has placed various restrictions on imported steel for the past two decades. The current quotas expire this September. George Bush must decide whether or not to renew them. If he bases his decisions on the record of the steel quotas in the past, his decision will be simple. He will scrap the trade restrictions on steel.

Among the reasons for this:

◆ ◆ For twenty years the large American steel producers have been given what was supposed to be temporary protection of their industry. At the end of each period of protection, the industry has sought, and usually received, new protection.

◆ ◆ Restraints on steel imports have removed incentives for modernization of the U.S. industry.

◆ ◆ The current steel import quotas have cost the U.S. economy a net loss of 37,000 jobs. For every steel job "saved," three jobs were lost in other industries.

♦ ♦ Five years of steel quotas have added $18 billion to the cost of U.S. steel.

♦ ♦ American manufactures that use steel in their products particularly have suffered. They have found it more difficult to meet foreign competition due to high steel costs.

♦ ♦ The U.S. steel industry has recovered from the recession of the early 1980s. Last year, industry profits were $2 billion. Smaller steel producers are especially efficient and are competing internationally.

♦ ♦ The attempt to use protectionism to eliminate foreign governments' subsidies to foreign steel producers is futile.

Testing Bush's Mettle. Bush has an obligation to protect the American economy as a whole. He also has expressed his support on many occasions for free markets and free trade. There is no good case for further damaging the U.S. economy with limits on steel imports in order to protect part of the U.S. steel industry.

In today's economy, steel is no longer the industrial king it was in the first half of this century. The U.S. economy has moved into economically more important high-technology industries such as computers, data processing software, telecommunications equipment, aircraft and spacecraft. In addition, there are abundant of steelmakers in today's world, and there is no danger that the U.S. will fail to find suppliers.

Free Market Opportunity. Bush is committed to opening further foreign markets to U.S. exports. To do so, he must convince foreign governments that free trade is good for all and that trade protectionism harms the "protected" market as well as the country whose goods are excluded. Protectionist policies by the U.S. show these claims to be empty rhetoric.

Bush has an opportunity to demonstrate his support for free market principles and to help the U.S. economy in the process. Twenty years of addiction to steel import quotas have harmed the U.S. economy and the steel industry itself. The President should announce that the "Voluntary" Restraint Agreements will not be renewed.

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